Supreme Court, U.S.
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In The

Supreme Court of the United States

INOVA DIAGNOSTICS, INC.,

Petitioner,

vs.

CAROLE KEETON STRAYHORN, COMPTROLLER OF PUBLIC ACCOUNTS OF THE STATE OF TEXAS; AND GREG ABBOTT, ATTORNEY GENERAL OF THE STATE OF TEXAS,

Respondent.

On Petition For Writ Of Certiorari To The Court Of Appeals Of Texas, Third District, Austin

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Public Law 86-272 (15 U.S.C. §§ 381-384) defines "net income tax" as "any tax imposed on or measured by net income." Is the Texas franchise tax on net taxable capital a "net income tax" under Public Law 86-272?

PARTIES TO THE PROCEEDING

INOVA DIAGNOSTICS, INC., Petitioner, is a California corporation doing business in Texas. Petitioner does not have a parent corporation, and no publicly held company owns more than ten percent of Petitioner's stock.

CAROLE KEETON STRAYHORN, Respondent, is the Comptroller of Public Accounts of the State of Texas.

GREG ABBOTT, Respondent, is the Attorney General of the State of Texas.

TABLE OF CONTENTS

	Page
QUESTION PRESENTED	i
PARTIES TO THE PROCEEDING	ii
TABLE OF CONTENTS	iii
TABLE OF AUTHORITIES	v
CITATIONS OF OPINIONS ENTERED IN THIS CASE	1
BASIS FOR SUPREME COURT JURISDICTION	1
STATUTES AND REGULATIONS INVOLVED IN THE CASE	1
STATEMENT OF THE CASE	2
ARGUMENT	6
A. THIS COURT SHOULD EXERCISE ITS JURISDICTION TO RESOLVE THE IMPORTANT QUESTION OF HOW PUBLIC LAW 86-272 SHOULD BE APPLIED TO STATE TAX SYSTEMS	6
B. THE COURT OF APPEALS ERRED BY ALLOWING THE COMPTROLLER TO INTERPRET AND APPLY PUBLIC LAW 86-272 IN CONTRAVENTION OF THE PLAIN LANGUAGE OF THE STATUTE	9
1. The plain language of Public Law 86-272 indicates that it applies to a broad category of state taxes	10
2. The taxable capital component of the Texas franchise tax is imposed on or measured by net income	14

TABLE OF CONTENTS – Continued

Page

3. The court of appeals incorrectly relied on cases from other states in holding that the taxable capital component of the franchise tax is not a net income tax under Public Law 86-272 18

C. THE COURT OF APPEALS ERRED BY ALLOWING THE COMPTROLLER TO INTERPRET AND APPLY PUBLIC LAW 86-272 IN CONTRAVENTION OF CONGRESS' STATED INTENT 21

1. Congress used broad language in Public Law 86-272 because it intended the statute to counteract a broad U.S. Supreme Court decision 21

2. Congress used broad language in Public Law 86-272 because it intended the statute to exempt taxpayers from a broad category of state taxes 23

3. Congress identified the types of state taxes that it intended to exclude from the definition of "net income tax." 26

4. Congress' stated goals are thwarted by the court of appeals' narrow interpretation of the statute 26

TABLE OF AUTHORITIES

Page

CASES

Alabama v. Acker, 527 U.S. 423, 119 S. Ct. 2069, 144 L. Ed. 2d 408 (1999) 14, 15

Ardire v. Tracy, 674 N.E.2d 1155 (Ohio 1997) 18

Clairol v. Kingsley, 262 A.2d 213 (N.J. Sup. Ct. App. Div. 1970) 18, 19, 20

Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 99 L. Ed. 483, 75 S. Ct. 473 (1955) 11, 21

Commissioner v. Wilcox, 327 U.S. 404, 90 L. Ed. 752, 66 S. Ct. 546 (1946) 11

First Agric. Nat'l Bank v. Commission, 392 U.S. 339, 88 S. Ct. 2173, 20 L. Ed. 2d 1138 (1968) 14

General Dynamics Corp. v. Bullock, 547 S.W.2d 255 (Tex. 1976) 16, 17, 19, 21

Gillette Co. v. Department of the Treas., 497 N.W.2d 595 (Mich. Ct. App. 1993) 18, 19

Howard v. Commissioner of the Sinking Fund of the City of Louisville, 344 U.S. 624, 73 S. Ct. 465, 97 L. Ed. 617 (1953) 11, 12, 13

Humble Oil & Refining Co. v. Calvert, 478 S.W.2d 926 (Tex. 1972) 10, 11

INOVA Diagnostics, Inc. v. Strayhorn, 166 S.W.3d 394 (Tex. App. 2003) ..... *passim*

Louisville v. Sebree, 214 S.W.2d 248 (Ky. Ct. App. 1948) 13

National Private Truck Council v. Commissioner, 688 N.E.2d 936 (Mass. 1997) 7

TABLE OF AUTHORITIES – Continued

Page

Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 79 S. Ct. 357, 3 L. Ed. 2d 421 (1959) 7, 21, 22

Schering-Plough Healthcare Prods. Sales Corp. v. Commonwealth, 805 A.2d 1284 (Pa. Commw. Ct. 2002) 7

Trinova Corp. v. Michigan Dep't of Treas., 498 U.S. 358, 111 S. Ct. 818, 112 L. Ed. 2d 884 (1991) 19

Wisconsin Dep't of Revenue v. William Wrigley, Jr., Co., 505 U.S. 214, 112 S. Ct. 2447, 120 L. Ed. 2d 174 (1992) 7

STATUTES

Pub. L. No. 86-272, Title I, § 101, Sept. 14, 1959, 73 Stat. 555 (codified in 15 U.S.C. §§ 381-84) (Public Law 86-272) ..... *passim*

Tex. Tax Code Ann. § 171.001 (West 2005) 1

Tex. Tax Code Ann. § 171.002 (West 2005) 1, 3, 4

Tex. Tax Code Ann. § 171.101 (West 2005) 1, 16

Tex. Tax Code Ann. § 171.109 (West 2005) 1, 16

ADMINISTRATIVE RULES

Comptroller Rule (34 Tex. Admin. Code) 3.547 ..... 2, 8

OTHER AUTHORITIES

Black's Law Dictionary (5th ed. 1979) 16

Conf. Rep. No. 86-1103, 86th Cong., 1st Sess. (Sept. 1, 1959) 3, 21, 22

TABLE OF AUTHORITIES – Continued

Page

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Random House Compact Unabridged Dictionary (Spec. 2d ed. 1996) 14

Reply Brief of Appellants (in the Third Court of Civil Appeals) in *General Dynamics Corp. v. Bullock*, 547 S.W.2d 255 (Tex. 1976) 17

Respondent's Supplemental Brief (in the Texas Supreme Court) in *General Dynamics Corp. v. Bullock*, 547 S.W.2d 255 (Tex. 1976) 17

S. Rep. 86-658, 86th Cong., 1st Sess. (Aug. 11, 1959) ..... *passim*

CITATIONS OF OPINIONS ENTERED IN THIS CASE

INOVA Diagnostics, Inc. v. Strayhorn, 166 S.W.3d 394 (Tex. App. 2003) (Appendix at A-1).

BASIS FOR SUPREME COURT JURISDICTION

The Court of Appeals for the Third Judicial District of Texas at Austin, Texas, entered its judgment in this case on May 26, 2005. Judgment (Appendix at A-19). Petitioner INOVA Diagnostics, Inc. timely filed a Petition for Review of the case in the Texas Supreme Court. The Petition for Review was denied by the Texas Supreme Court on December 2, 2005. Official Notice from the Supreme Court of Texas (Appendix at A-18). This Petition for Writ of Certiorari is timely filed under 28 U.S.C. § 2101(c) and under Rule 13.3 of this Court.

This Court has jurisdiction under 28 U.S.C. § 1257 to review on a writ of certiorari the judgment of the highest court of a state when the principal issue is the validity of a federal statute or the claim of a right, title, privilege, or immunity under a federal statute.

STATUTES AND REGULATIONS INVOLVED IN THE CASE

Public Law 86-272 (codified in 15 U.S.C. §§ 381-84) (Appendix at A-62 to A-64).

Texas Tax Code §§ 171.001, 171.002, 171.101, 171.009, 171.110 (Appendix at A-92 to A-106).

Comptroller Rules (34 Tex. Admin. Code) §§ 3.546, 3.547, 3.554 (Appendix at A-107 to A-124).

STATEMENT OF THE CASE

This case concerns Petitioner INOVA Diagnostics, Inc.'s ("INOVA") contention that Public Law 86-272, a federal statute, prevents the State of Texas from imposing any portion of its franchise tax on INOVA. The Texas franchise tax is comprised of two components – the tax on taxable capital and the tax on earned surplus. The Texas Comptroller of Public Accounts' ("Comptroller") administrative policy provides that Public Law 86-272 exempts INOVA from the tax on earned surplus but not the tax on taxable capital.

Public Law 86-272 prohibits a state from imposing a "net income tax" on an entity performing only activities related to the solicitation of orders for sales of its products in the state. Pub. L. No. 86-272, Title I, § 101, Sept. 14, 1959, 73 Stat. 555 (codified in 15 U.S.C. §§ 381-84) (hereinafter cited as "Pub. L. No. 86-272 (15 U.S.C. § ___)") (Appendix at A-62). Public Law 86-272 provides:

> § 381. Imposition of net income tax
>
> (a) Minimum standards. No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after the date of the enactment of this Act [enacted Sept. 14, 1959], a net income tax on the income derived within such State by any person from interstate commerce *if the only business activities within such State* by or on behalf of such person during

such taxable year are either, or both, of the following:

(1) *the solicitation of orders by such person*, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State . . .

. . . .

§ 383. "Net income tax" defined

For purposes of this title [*15 USCS §§ 381* et seq.], the term "net income tax" means any tax imposed on, or measured by, net income.

Pub. L. No. 86-272 (15 U.S.C. §§ 381(a)(1), 383) (emphasis added) (Appendix at A-62, A-64).

The Texas franchise tax is a state tax assessed against certain business entities doing business in the state. Tex. Tax Code Ann. § 171.001 *et seq.* (West 2005) (Appendix at A-92). In calculating the amount of franchise tax due, taxpayers are required to calculate two components – one based on the taxpayer's "net taxable capital" and the other based on the taxpayer's "net taxable earned surplus." Tex. Tax Code Ann. § 171.002 (West 2005) (Appendix at A-94). Texas Tax Code § 171.002 provides:

§ 171.002. Rates; Computation of Tax

(a) The rates of the franchise tax are:

(1) 0.25 percent per year of privilege period of *net taxable capital*; and

(2) 4.5 percent of *net taxable earned surplus*.

(b) The amount of franchise tax on each corporation is computed by adding the following:

(1) the amount calculated by applying the tax rate prescribed by Subsection (a)(1) to the corporation's net taxable capital; and

(2) the difference between:

(A) the amount calculated by applying the tax rate prescribed by Subsection (a)(2) to the corporation's net taxable earned surplus; and

(B) the amount determined under Subdivision (1).

(c) In making a computation under Subsection (b), an amount computed under Subsection (b)(1) or (b)(2) that is zero or less is computed as a zero.

Tex. Tax Code § 171.002 (emphasis added) (Appendix at A-94).

INOVA filed its original lawsuit in Travis County District Court contending that Public Law 86-272 exempts it from the payment of any Texas franchise taxes because both components of the Texas franchise tax are "imposed on, or measured by, net income." Pl.'s 1st Am. Orig. Pet. (Appendix at A-46 to A-50 (Count 1)). The trial court entered judgment against INOVA on July 22, 2004. Judgment (Appendix at A-19). The Court of Appeals issued its opinion affirming the trial court on May 26, 2005. *INOVA*, 166 S.W.3d 394 (Tex. App. 2003) (Appendix at A-1). INOVA's Petition for Review to the Texas Supreme Court, the highest court of the state for civil cases, was denied on December 2, 2005. Official Notice from the Supreme Court of Texas (Appendix at A-18).